



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

*file copy*

Date: DEC 19 2000

NO PROTEST RECEIVED  
Release copies to District  
Date: [REDACTED]  
Surname: [REDACTED]

Contact Person: [REDACTED]

Identification Number: [REDACTED]

Contact Number: [REDACTED]

[REDACTED]

Employer Identification Number: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

You were incorporated on [REDACTED] as an [REDACTED] not-for-profit corporation. According to your articles of incorporation, you are organized to raise money through business activity, investments, and to engage in any lawful act or activity for which corporations may be organized under the general corporation law of [REDACTED]. You will gift money to non-profit groups.

On page 2 of your application, you stated that 40 % of your time will be devoted to leasing ATMs for profit through a partnership and 20 % will be devoted to working with an affordable housing organization, [REDACTED] (which is not listed in Publication 78). When questioned about these activities, you responded that you have not and do not plan to do them. Your application also stated that 20 % of your time will be devoted to buying (and receiving as gifts) and selling properties, land, and equipment. When asked for more details on these activities, you responded that you are not doing these things at this time. When asked for more details on the nonprofit organizations to which you will make grants, you responded that no grants have been granted and that you will provide the desired information when it is available.

In a letter you stated that you have entered into a partnership to own and operate [REDACTED]. A letter of agreement you submitted states that the partnership is to market inbound and outbound dialers and various other products to small businesses and churches. The letter also states that your partner will operate the partnership through its permanent location. You will operate from an office in [REDACTED]. You will divide profits equally between yourself and your partner. Your balance sheet shows a debt of \$ [REDACTED] and net assets of minus \$ [REDACTED].

Section 501(c)(3) of the Internal Revenue Code exempts from federal income tax

organizations organized and operated exclusively for charitable or certain other purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation.

Section 502(a) of the Internal Revenue Code states that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt from taxation under section 501 on the ground that all of its profits are payable to one or more organizations exempt from taxation under section 501.

Section 502(b)(3) of the Internal Revenue Code states that for purposes of this section, the term 'trade or business' shall not include any trade or business which is the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions.

Section 4943 of the Code imposes a tax on the excess business holdings of a private foundation that is engaged in a business enterprise. Initially this tax is equivalent to five percent of the value of business holdings however if the foundation continues to have excess business holdings at the close of the taxable period, the tax rises to two hundred percent.

Section 1.501(c)(3)-1(a)(1) of the Regulations states that in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section.

Section 1.501(c)(3)-1(a)(4) of the Regulations states that an organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization's assets will be considered dedicated to an exempt purpose, for example, if, upon dissolution, such assets would, by reason of a provision in the organization's articles or by operation of law, be distributed for one or more exempt purposes, or to the federal government, or to a state or local government for a public purpose, or would be distributed by a court to another organization to be used in such manner as in the judgment of the court will best accomplish the general purposes for which the dissolved organization was organized.

Section 1.501(c)(3)-1(b)(1)(iii) of the Regulations states that "an organization is not organized exclusively for one or more exempt purposes if its articles expressly empower it to carry on, otherwise than as an insubstantial part of its activities, activities which are not in furtherance of one or more exempt purposes. Thus, an organization that is empowered by its articles 'to engage in a manufacturing business' does not meet the organizational test regardless of the fact that its articles may state that such organization is created 'for charitable purposes within the meaning of section 501(c)(3) of the Code'".

Section 1.501(c)(3)-1(c)(1) of the Regulations provides that an organization "operates exclusively" for 501(c)(3) purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3). It does not operate exclusively for 501(c)(3) purposes if more than an insubstantial part of its activities does not further such

purposes.

Section 1.501(c)(3)-1(d)(2) of the Regulations states that the term 'charitable' is used in its generally accepted legal sense. This term includes the advancement of religion.

Section 1.501(c)(3)-1(e)(1) of the Regulations states that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business.

Rev. Rul. 98-15, 1998-12 I.R.B. 1 provides the criteria that organizations seeking exemption must meet if they are involved in a limited liability company with a for-profit entity. The revenue ruling provides precedent for imputing the activities of a partnership to its members. "For federal income tax purposes, the activities of a partnership are often considered to be the activities of the partners. In light of the aggregate principle discussed in Butler . . . , the aggregate approach also applies for purposes of the operational test set forth in section 1.501(c)(3)-1(c) of the Regulations."

"A section 501(c)(3) organization may form and participate in a partnership and meet the operational test if participation in the partnership furthers a charitable purpose and the partnership arrangement permits the exempt organization to act exclusively in furtherance of its exempt purpose and only incidentally for the benefit of the for-profit partners. However, if a private party is allowed to control or use the non-profit organization's activities or assets for the benefit of the private party the organization will fail to be organized and operated exclusively for exempt purposes."

The revenue ruling concludes by providing criteria to determine whether an organization involved in a partnership qualifies to be an exempt organization under section 501(c)(3) of the Code. The governing documents of the partnership must commit it to charitable activities. In addition, appointees of the exempt organization have control over the partnership. In this manner, the exempt organization is able to ensure that the assets that it owns through the partnership as well as the activities it conducts are used to further exempt purposes.

In Better Business Bureau v. United States, 316 U.S. 279 (1945), the Supreme Court held that an organization is not organized and operated exclusively for charitable purposes if it has a substantial non-exempt purpose. The Court stated that "the presence of a single . . . [non-exempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [exempt] purposes."

Butler v. Commissioner, 36 T.C. 1097 (1961) stands for the proposition that when a partnership engages in an activity, its partners necessarily engage in the same business. "By reason of being a partner in a business petitioner was individually engaged in business."

Plumstead Theatre Society Inc. v. Commissioner, 74 T.C. 1324, 1333-34 (1980) granted tax exemption under section 501(c)(3) of the Code to an organization that entered into a limited

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partnership with two other partners. The organization seeking tax-exempt status was not obligated to return funds that the limited partners had contributed. In addition, the limited partners had no control over the way that the petitioner operated or managed its affairs.

In Broadway Theatre League of Lynchburg, Va. Inc. v. U.S., 293 F. Supp. 346 (1968) the Court granted tax-exempt status to an organization in part because the organization retained ultimate authority over the activities being managed.

est of Hawaii v. Commissioner, 71 T.C. 1067 (1979) denied tax-exempt status under section 501(c)(3) of the Code to an organization. The Court found that several for-profit organizations exerted significant indirect control over the organization seeking tax-exempt status.

Harding Hospital Inc. v. United States, 505 F. 2d 1068 (6<sup>th</sup> Cir. 1974) denied tax-exempt status under section 501(c)(3) of the Code to a non-profit hospital due to a contract that the hospital entered into with a partnership composed of physicians. The contract gave the physicians control over care of the hospital's patients and the stream of income generated by the patients while also guaranteeing the physicians thousands of dollars in payment for various supervisory activities. The Court concluded by holding that the benefits derived from the contract constituted sufficient private benefit to preclude exemption.

The court in Living Faith, Inc. v. Commissioner, 950 F.2d 365 (7<sup>th</sup> Cir. 1991) ruled against the taxpayer on the grounds that it was operated for non-exempt purposes. The taxpayer in this case operated two vegetarian restaurants and health food stores in a manner which was consistent with its religious beliefs. However, the court determined that the taxpayer operated for a commercial purpose due to the 'strong commercial hue' of the taxpayer's operations. Specifically the court determined that the taxpayer's price formulas, its reliance on advertising, its lack of plans to seek grants, and other factors such as its hours of operation all indicated a 'strong commercial hue' to the taxpayer's operations. The court concluded by stating that the taxpayer operated with a 'substantial commercial purpose' and consequently was not entitled to tax-exempt status under section 501(c)(3) of the Code.

In Federation Pharmacy Services, Inc. v. Commissioner, 72 T.C. 687 (1979), the court upheld the Commissioner's denial of exemption under section 501(c)(3) of the Code. The organization was organized to operate a pharmacy to sell drugs at discount prices to elderly and handicapped persons. The organization served elderly and handicapped people almost exclusively and did not sell toiletry articles, magazines, cards, or other items normally sold for profit by pharmacies. The organization's board consisted of community leaders. The organization used the services of volunteers instead of paid employees. All gifts were used for the benefit of financially distressed senior citizens who, because of a catastrophic illness or accident, incurred large prescription drug bills. The court reasoned that the organization operated its business primarily for commercial purposes, in competition with profit-making drug stores. The mere fact that products sold by the organization were helpful to health did not necessarily entitle it to exemption under section 501(c)(3) of the Code.

In American Institute for Economic Research v. United States, 157 Ct.Cl. 548, 555; 302

[REDACTED]

F:2d 934, 937-38 (1962), cert. denied, 372 U.S.976 (1963) the court upheld the Commissioner's denial of exemption under section 501(c)(3) of the Code. The organization's stated purposes were to conduct scientific research in economics and disseminate the results to educate the public. The organization had two publications which contained brief analyses of industries and individual securities. Subscribers were entitled to a quarterly list of securities recommended by the organization. The organization provided various investment advisory services for a fee. The organization's educational activity was relatively small in scale with intermittent interruptions. The court reasoned that the organization's exempt purposes were incidental to its primary purpose to conduct business. The court noted that even though the organization's activities may have been educational, the organization had profits, the organization's services were commonly associated with commercial enterprises, and the organization received no bona fide charitable contributions, which indicated a substantial non-exempt purpose.

Section 501(c)(3) of the Code requires organizations seeking tax-exempt status to be organized exclusively for charitable or certain other purposes. Section 1.501(c)(3)-1(a)(4) of the Regulations states that an organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. Section 1.501(c)(3)-1(b)(1)(iii) of the Regulations states that an organization is not organized exclusively for one or more exempt purposes if its articles expressly empower it to carry on activities which are not in furtherance of one or more exempt purposes. Section 1.501(c)(3)-1(a)(1) of the Regulations states that in order to be exempt as an organization described in section 501(c)(3), an organization must be organized exclusively for an exempt purpose. Your articles of incorporation do not have language stating that you are organized and operated exclusively for exempt purposes. Furthermore, your articles do not have a dissolution clause stating that your assets are dedicated to an exempt purpose. Lastly, your articles empower you to carry on activities that are not in furtherance of an exempt purpose. Your articles of incorporation do not comply with these regulations. As a result, you do not qualify for tax-exempt status under section 501(c)(3) of the Code.

Section 502(a) of the Code states that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt from taxation on the ground that all of its profits are payable to one or more organizations exempt from taxation under section 501. Section 1.501(c)(3)-1(e)(1) of the Regulations states that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business if the operation of such trade or business is in furtherance of the organization's exempt purpose and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business. You will market inbound and outbound dialers and various other products to small businesses and churches. Based on the facts submitted, your primary purpose is to conduct an unrelated trade or business. This activity conflicts with section 502(a) of the Code and as a result you do not operate exclusively for exempt purposes. You are not described under section 501(c)(3) of the Code.

Section 1.501(c)(3)-1(c)(1) of the Regulations provides that an organization "operates exclusively" for 501(c)(3) purposes only if it engages primarily in activities that accomplish one or more exempt purposes. Rev. Rul. 98-15, 1998-12 I.R.B. 1 provides the criteria that organizations seeking exemption must meet if they are members of a partnership. A section

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501(c)(3) organization may participate in a partnership if the participation furthers a charitable purpose and the partnership arrangement permits the exempt organization to act exclusively in furtherance of its exempt purpose. The letter of agreement governing your partnership does not commit it to charitable activities; instead it commits the partnership to selling automated telephone dialers. In addition, you do not have control over the partnership as it will be operated by your partner. Plumstead Theatre Society Inc., Broadway Theatre League of Lynchburg, Va. Inc., est of Hawaii, and Harding Hospital Inc. stand for the proposition that an organization seeking tax-exempt status which is also a member of a partnership must retain control over its own operations so that it is able to act to further its exempt purposes. Your participation in the partnership will not further exempt purposes and consequently you do not qualify for tax-exempt status under section 501(c)(3) of the Code.

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

Contributions to you are not deductible under section 170 of the Code.

In the event that you did satisfy the requirements for tax-exempt status under section 501(c)(3) of the Code, your manner of operations would preclude from qualifying for public charity status under section 509(a)(3) of the Code. Section 1.509(a)-4 of the Regulations has three subsections that are germane to your case.

Subsection (A) requires organizations to be organized and operated exclusively for the benefit of or to carry out the purposes of one or more specified organizations. Section 1.509(a)-4(c) states that an organization must state the name of the publicly supported organization it will support. In addition, section 1.509(a)-4(e) of the Regulations states in essence that a supporting organization must act exclusively to support a specified publicly supported organization. You have not stated the names of the organizations you will support and as a result, you do not satisfy subsection 509(a)(3)(A) of the Code.

Subsection (B) requires organizations to be operated, supervised, or controlled by or in connection with one or more of the organizations they support. Section 1.509(a)-4(f)(2) of the Regulations defines this as being operated, supervised, or controlled by; supervised or controlled in connection with; or operated in connection with a benefited organization. There is no common control between you and a supported organization. Furthermore, you select your own governing board. Consequently, you do not satisfy subsection 509(a)(3)(B) of the Code. In the event that you did qualify for tax exempt status under section 501(c)(3) of the Code, you would be classified as a private foundation. As a private foundation, your business activities would appear to be prohibited excess business holdings and as such would be subject to taxation under section 4943 of the Code as excess business holdings.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you

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are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service  
[REDACTED] T:EO:RA:T:2, Room 6539  
1111 Constitution Ave, N.W.  
Washington, D.C. 20224

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

(signed) TLS

Robert Fontenrose  
Acting Manager  
Exempt Organizations  
Technical Group 2